

Political control of state-owned utilities in the UK

Tim Tutton
Centre for Competition Policy
University of East Anglia

CCP Working Paper 19-8

Abstract

Political control of utilities is problematic. On the one hand, the industries have high political salience, meaning that politicians want a serious say in what they deliver. On the other hand, day-to-day political intervention tends to have a high cost in terms of damage to operating efficiency. The UK solution to this conflict has typically been for government to appoint an agent, with a high degree of independence from ministers, to deliver the government's objectives for the utility in question. The agents have been the boards of the public corporations in the nationalised era and the economic regulators in the privatised era. This paper looks at what lessons can be learned from both eras to answer the question of how might political control be better exercised than in the past, in the event that utilities are renationalised. A core conclusion is the desirability of an independent agency (whether or not called a 'regulator') between the minister and the utility, with a transparent ministerial brief to that agency on how it should interpret its (inevitably high-level) statutory obligations.

Contact Details:

Tim Tutton

T.Tutton@uea.ac.uk

Political control of state-owned utilities in the UK

Tim Tutton

Centre for Competition Policy, University of East Anglia

1 Introduction

For a time after the UK utility privatisations of the 1980's and 1990's, political control of the previously nationalised entities fitted into an 'end of history' narrative. In other words, there was a broad consensus across the main political parties that:

- at least most of the utilities should be in the private sector; and
- the main instrument of control of these industries should be 'independent' regulators who would operate within a statutory framework, set (and modifiable) by Parliament.

However, this position somewhat broke down with the 2015 change in the leadership of the Labour Party and was reflected in the 2017 Labour Party Manifesto.

"Across the world, countries are taking public utilities back into public ownership. Labour will learn from these experiences and bring key utilities back into public ownership to deliver lower prices, more accountability and a more sustainable economy. We will:

- Bring private rail companies back into public ownership as their franchises expire.
- Regain control of energy supply networks through the alteration of operator licence conditions, and transition to a publicly owned, decentralised energy system.
- Replace our dysfunctional water system with a network of regional publicly-owned water companies.
- Reverse the privatisation of Royal Mail at the earliest opportunity."¹

This paper is not about the desirability, or otherwise, of bringing privatised utilities back into public ownership. Rather, it is about, in the event of such a change, how government should seek to most effectively control or 'regulate' the industries in question in order to achieve its objectives for those industries. To this end, the following issues are addressed.

- Why political 'control' of utility industries has been, and is, so problematic and why this is true, regardless of whether the entities are privately or publicly owned - and why, therefore, both the experience with nationalised industries in the UK (from the 1940's to the 1980's) and the experience with the privatised industries, from the 1980's onwards, are relevant to the question of how to exercise future political control over state-owned utilities (SOUs).
- How control issues were initially addressed with the nationalisations which took place in the wake of the Second World War and what problems arose, some of them identified in the very early days of the nationalised era.

¹ Labour Party (2017), 'For the many not the few: the Labour Party Manifesto 2017', p. 19. <https://labour.org.uk/wp-content/uploads/2017/10/labour-manifesto-2017.pdf>

- How the political control framework for the nationalised industries subsequently evolved and the extent to which the changes mitigated the problems.
- How these issues were initially addressed with the privatised utilities.
- How political control of utilities has since evolved.
- What can be learned from these two sets of experience in designing a control regime in respect of future political control of SOUs?

2 Why is political 'control' of utilities so problematic, regardless of who owns them?

The starting point for why political control of utilities is an issue is that the industries in question have high political salience which derives from the nature of the products and services which they provide. Whether it is energy, water, transport or others, they are the sort of industries where, when things go wrong (higher prices, interruptions of supply etc), politicians' careers are on the line. It is, therefore, unsurprising that politicians want to have a serious say in how these industries are run. Beyond that, the political salience of utilities has been increased by the overlaps between the services which utilities provide and important areas of government policy – security of supply, environmental objectives, universal service obligations, social policy ('energy poverty', 'water poverty', 'vulnerable' customers), to name but a few.

However, at the same time, there has been a general recognition (as much in the late 1940's, at the time of the post-Second World War nationalisations, as more recently) that there will be negative consequences, not least for operational efficiency, if political control is exercised directly over the companies in any day-to-day sense. These consequences have been seen as taking two main forms.

First (and this was a core reason for the framework for the control/management initially established for the industries nationalised after the Second World War) is the view that the industries in question should be managed by people who know something about running such industries – and that this would not typically include ministers or indeed politicians more generally. This need for at least day-to-day management of the industry to be in the hands of industry professionals has also been more recently echoed in the Labour Party's plans for renationalisation of the English water industry, albeit with the qualifier that the professionals who will be responsible for day-to-day operations are defined as including "both management and workforce"².

Second, the privatisations of the 1980s and 1990s threw up the additional (and privatisation-specific) issue that political interference in the day-to-day running of the companies might not just get in the way of efficient operational management but also in the way of raising (private) capital. As noted by Parker, in relation to the discussion about the role of politicians in the regulation of British Telecoms in the run-up to the company's privatisation, "An early proposal involved the Secretary of State having the final say on licence amendments, but the Department's financial advisers, Kleinworts, suggested that without some clear distancing of the decision from political control, a successful flotation was unlikely to be achieved"³.

In other words, regardless of whether utilities are privately owned or state-owned, there is still the fundamental conflict between, on the one hand, the desirability (on grounds of operational efficiency and maybe also of financeability) of keeping politicians away from the day-to-day running

² Labour Party (2018), 'Clear Water: Labour's vision for a modern and transparent publicly-owned water system'. <https://www.labour.org.uk/wp-content/uploads/2018/09/Conference-2018-Water-pamphlet-FINAL.pdf>

³ Parker, David (2009), 'The Official History of Privatisation, Volume I', Routledge, p. 268

of companies and, on the other hand, the political salience of what utilities do. Also, regardless of ownership, governments (in their role as 'principals') have used the same high-level means of trying to mitigate this conflict - that is through delegation to 'agents' and through giving those agents a degree of autonomy from ministers. What has been different between the nationalised and privatised eras has been the choice of agents.

In the case of the post-World War 2 nationalisations, the agents were the boards of the state-owned corporations. In the privatised world, the main agents have been the economic regulators. But, as will be suggested below, many of the problems with how ministers interact with their chosen agents have been markedly similar.

Some of these problems may characterise principal-agent relationships in general: the tendency of principals to circumvent formal (and relatively transparent) control mechanisms by resort to more informal (and less transparent) mechanisms; the asymmetry of information between principal and agent; the tendency of agents to develop their own agendas; the difficulty of writing a complete 'contract' with the agent. However, other similarities reflect characteristics of utilities. The conflict between the often long lives of assets in what are capital-intensive industries conflict and the typical time horizons of politicians is one example. But it is the political salience of utilities - the acute difficulty of keeping politics (and politicians) out of 'what utilities do' - which is the main continuing utility-specific thread in the principal-agent problems which run through both nationalised and privatised eras.

During the nationalised era, some of the problems in the relationship between ministers and nationalised industry boards were catalogued by the National Economic Development Office (NEDO) in a 1976 report. In relation to the role of ministers (and Parliament more generally), NEDO noted, in particular, that "there is confusion about the respective roles of the boards of the nationalised industries, Ministers and Parliament, with the result that accountability is seriously blurred"⁴. (As described in Section 5 below, the Government of the day largely ignored NEDO's recommendations for improving the situation.)

But the issues were there, and perceived to be there, from the early days of the nationalised era. In 1950, *Political Quarterly* devoted the whole of one volume to nationalised industries ("by far the most important domestic question facing the British people at the present time"⁵). In it, D.N. Chester (later to write the official history of nationalisation) wrote that "the main organisational weakness likely to result from the form adopted in the nationalisation Acts is the uncertain division of responsibility between the [public corporation] board and the Minister"⁶. In the same volume, Ernest Davies M.P. (later to be a minister in the then Labour Government) bemoaned the way that the lack of transparency in the relationship between ministers and boards undermined the parliamentary accountability of both ministers and the industries themselves.⁷

During the privatised era, there have been at least two major attempts to draw a clearer dividing line between the role of Ministers and that of their agents in relation to the utilities, the economic regulators: by the House of Lords Select Committee on Economic Regulators in 2007⁸ and by the

⁴ National Economic Development Office (1976), 'A Study of the UK Nationalised Industries', HMSO, p. 8

⁵ *Political Quarterly* (1950), Vol 20(2), 'Notes and Comments', pp. 109-113

⁶ Chester, D.N. (1950), 'Organisation of the Nationalised Industries', *ibid.* pp. 122-134

⁷ Davies, E. (1950), 'Ministerial Control and Parliamentary Responsibility of Nationalised Industries', *ibid.*, pp. 150-159

⁸ House of Lords Select Committee on Regulators (2007), 'UK Economic Regulators', November. <https://publications.parliament.uk/pa/ld200607/ldselect/ldrgltrs/189/189i.pdf>

then Department of Business, Innovation and Skills (BIS) in 2011⁹. The recommendations of the first of these largely sank without trace and the recommendations of the latter (mainly for there to be Strategy and Policy Statements, via which ministers would give guidance to regulators on how they should interpret their statutory obligations) have been treated by the relevant ministers with only slightly more enthusiasm than greeted the NEDO report in 1976.

Against this background the following sections examine the evolution of the principal-agent relationships in the nationalised era (between ministers and public corporation boards) and since privatisation (between ministers and economic regulators) - and seeks to identify common themes in what has gone wrong and why.

3 How political control was initially addressed with the 1940's nationalisations

The political governance model adopted for the industries which were nationalised in the late 1940's, and which was embodied in the various nationalisation Acts¹⁰, was broadly that outlined by Herbert Morrison (one of the main architects of the nationalisation process) in 1933 in his book *Socialisation and Transport*¹¹. As the title implies, Morrison was writing specifically about transport, and particularly about transport in London, but was explicit that his proposed model was applicable to (and preferable for) "other undertakings of a predominantly business or commercial character"¹².

In his book, Morrison dismissed the two then current models for state enterprise - one where the enterprise concerned was run as a government department (as was the Post Office at the time) and the other where a municipality or a group of municipalities were in charge. Morrison dismissed many of the 'anti-Socialist' critiques of both models (the 'commercial incapacity' of Government departments or the quality of 'municipal officers', for example)¹³. However, despite this, he rejected the Government department model on the basis that, inter alia, he did not want the new entities to be constrained by civil service pay scales; he wanted management to be "sufficiently free from those undesirable pressures associated with both public and private Parliamentary strategy, political lobbying and electoral 'blackmail';¹⁴ and having a Minister at the head of each socialised industry, fully accountable for its affairs, would "require a greater number of Ministers than is healthy for the proper functioning of Parliament"¹⁵. The municipal model was rejected on the basis that an individual municipality would be too small, and 'municipal joint committees' (covering various individual municipalities) were "one of the least democratic of our instruments of public administration"¹⁶.

Instead, Morrison looked for new 'organ of economic management' and administration which "must be a public body; there must be public accountability of an appropriate form or forms; it must be efficient and speedy in action; it must have a social conscience, a corporate spirit and public

⁹ Department for Business, Innovation and Skills (2011), 'Principles for Economic Regulation', April. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/1-795-principles-for-economic-regulation.pdf

¹⁰ Coal Industry Nationalisation Act 1946, Civil Aviation Act 1946, Electricity Act 1947, Transport Act 1947, Gas Act 1948, Iron and Steel Act 1949

¹¹ Herbert Morrison (1933), 'Socialisation and Transport', Constable.

¹² *ibid.* p. 137

¹³ *ibid.* pp. 132 - 134

¹⁴ *ibid.* pp. 137-138

¹⁵ *ibid.* p. 139

¹⁶ *ibid.* p. 146

purpose; the legitimate rights of the consumer must be safeguarded; so also must be those of labour in the industry..... This brings us to the Public Corporation"¹⁷.

At the heart of the public corporation model, the state-owned corporations would be run by boards, with a prescribed 'arm's length' relationship between a board and the relevant Minister, in the same way that, with the privatised industries, there was intended to be a prescribed arm's length relationship between ministers and economic regulators of the utilities.

The general obligations on the boards were set at a high level in the various nationalisation Acts (as indeed were the initial statutory obligations on the economic regulators in the various privatisation Acts). Foremost among them were:

- a high-level objective (or objectives): in the case of the Board of the Central Electricity Authority, for example, "to develop and maintain an efficient, co-ordinated and economical system of electricity supply"¹⁸;
- a form of break-even financial obligation: again, in the case of the Central Electricity Authority, "to secure that the combined revenues of the Central Authority and all the Area Boards taken together are not less than sufficient to meet their combined outgoings properly chargeable to revenue account taking one year with another"¹⁹.

The formal powers of Ministers in relation to the Boards were set out in the various nationalisation Acts. Although there are variations between the Acts, there are also major similarities. Using the Electricity Act 1947 as an example, the main Ministerial powers in relation to the Board of the Central Electricity Authority were:

- to appoint the members of the Board, including the Chairman;
- to approve or veto major capital expenditure programmes;
- to approve or veto programmes in areas like training, education and research;
- to "give to that Authority such directions of a general character as to the exercise and performance by the Authority of their functions under this Act as appear to the Minister to be requisite in the national interest"²⁰.

Subject to the above, the Central Electricity Authority had, and was intended to have, a large amount of freedom to manage its own affairs.

4 Issues identified with the initial model

Dissatisfaction with the post-war political control model was expressed from an early stage, as described by Chester in his official history of the nationalisation process and as articulated, for example, in the contributions to the (already referred to) second 1950 volume of *Political Quarterly*. The problems identified (both in the early days after nationalisation and thereafter) included, in particular:

- the nature of the relationship between Ministers and the boards of the public corporations;
- the lack of incentives for the corporations to improve their efficiency;

¹⁷ *ibid.* p. 148

¹⁸ Electricity Act 1947, Section 1 (1)

¹⁹ *ibid.*, Section 36 (1)

²⁰ *ibid.*, Section 5 (1)

- linked to, but not the same as the previous point, the lack of incentives to achieve 'adequate' financial performance.

The relationship of ministers and public corporation boards and the accountability of both to Parliament

As noted in Section 3, the Morrisonian model for nationalisation gave the boards of the newly created public corporations substantial freedom in how they managed the companies, at least on a day-to-day basis. Leaving aside the specific areas where ministerial approval was required (like major capital programmes), what the model seems to have envisaged is that public interest/political objectives would be realised through a mixture of:

- not having dividend-seeking, private shareholders to satisfy ("The Public Corporation must be no mere capitalist business, the be all and end all of which is profits and dividends ...²¹);
- appointing the right sort of (public-spirited, as well as qualified) people to the company boards ("...appointments should be made on the basis of general competence, ability and public spirit for the task to be discharged"²²);
- the fact that both ministers and board members would be 'public servants'²³;
- the claim that "The Board would wish to earn the regard and esteem of Parliament and the public"²⁴; and
- through the ability of ministers to give formal 'directions' to a board on what might be termed 'policy'.

In addition, ministers would, in principle, be answerable to parliament for those directions - thus, giving MP's the ability to question the ministers and the ability to question the high-level direction of the public corporations without giving them the ability to interfere in day-to-day management.

In practice, ministers proved reluctant to give formal directions to company boards. As documented by Milligan, writing in 1951, not one such direction was issued between 1945 and 1951²⁵. Instead, ministers preferred to deal with boards, particularly chairmen of the boards, on a more informal basis. This preference for informal directions to company boards had the direct consequences of reducing the ability of MP's to hold ministers to account for their decisions, as well as allowing ministers to intervene in a public corporation's day-to-day affairs whenever they felt so inclined without being seen to have intervened.

The problems of reliance on a suitably appointed board to do the right thing (and on 'reputational' incentives) was compounded by a lack of statutory definition of what the public interest might mean - and, therefore, a lack of clear criteria for ministers to indicate when a board might be failing to act in the public interest. For example, and as noted above, there was, in the Electricity Act 1947, an obligation on the Central Electricity Authority to develop an efficient and coordinated system of electricity supply. It was, however, left to the Authority to determine how one might define this - how, for example, one might define an adequate margin of spare generating capacity in a world where the Authority alone was left to value the consequences of power cuts and to forecast future increases in electricity demand, the future costs of different types of generating plant and all the

²¹ Morrison, H., Op. cit, p. 156

²² *ibid.*, p. 178

²³ *ibid.*, p. 172

²⁴ *ibid.*, p. 174

²⁵ Milligan, F. (1951), 'Ministerial Control of the British Nationalised Industries', *Canadian Journal of Economics and Political Science*, vol. XVII, no. 2, May, pp. 164-183

other components of the calculation which a vertically integrated electricity monopoly needs to make decisions about investing in generating plant or other forms of electrical capacity.

In sum, the model for the political control of public corporations, as it evolved after nationalisation, was characterised by:

- corporations having a high degree of formal autonomy;
- little statutory guidance on how corporations should interpret their obligations, giving ministers and boards a high degree of discretion as to how to define the public interest; and
- in practice, the ability of ministers to intervene in the affairs of the public corporations but informally and away from Parliamentary (or other) scrutiny.

Later in the nationalisation period, a more detailed critique of the dysfunctionality of relationship between Ministers and Boards was developed by Parliamentary Select Committees and the National Economic Development Office (whose 1976 report is covered in Section 5 below). Vickers and Yarrow's summary of a 1968 report by the House of Commons Select Committee on Nationalised Industries is that "whereas Parliament's original intention was that ministers should provide general guidance to managements concerning enterprise objectives and should abstain from detailed interventions in operational matters, in practice the opposite had occurred: general guidance was rarely offered but specific interventions were common"²⁶.

The lack of incentives to improve efficiency

Unlike the RPI-X regulatory regime put in place for the privatised utilities, there were initially no explicit incentives for the nationalised industries to improve their efficiency - no controls on prices, no explicit financial obligations beyond the requirement to cover their costs 'taking one year with another' and no explicit sanctions even if this latter was not achieved.

In so far as Morrison considered the efficiency issue in advance of nationalisation being implemented, he seems to have considered that it would be improved by having an appropriately qualified board, by keeping politicians away from 'administration' of the nationalised companies and through economies of scale resulting from consolidation of fragmented industries into large units, which was one aspect of what nationalisation was about. As Chester put it in his official history of nationalisation: "Efficiency was not a subject which had loomed at all large in the literature of nationalisation. In some quarters it was assumed that a public body must inevitably be more efficient than a number of capitalist firms"²⁷ (much as, in the same way, some would later see privatisation per se as a route to improved efficiency).

However, this insouciance about the efficiency issue did not last long. Chester, writing about the immediate post-nationalisation period, describes how it soon moved up the political agenda.

"Several factors caused Ministers to have to worry about this issue [i.e. efficiency]. First, an increasing realisation that they had created giant monopolies. The fact the industries were publicly owned did not thereby ensure that they would not act like and be subject to the temptations of monopolies through the ages. Second it was brought home to Ministers that some of the boards conducted their undertakings either inefficiently or in ways hardly tolerable in public undertakings. It was not merely the Opposition and those who

²⁶ Vickers, J. and Yarrow, G. (1988), 'Privatisation: an Economic Analysis', MIT Press, p. 128

²⁷ Chester, Sir Norman (1975), 'The Nationalisation of British Industry 1945-51', pp. 1046 - 1047

*disliked nationalisation who called attention to these shortcomings. There were general grumbings about the performance of the nationalised industries and this was believed to a major factor in the declining popularity of the Labour Party*¹²⁸.

The lack of incentives to achieve adequate financial performance

As noted above, the only financial obligation in the various nationalisation Acts was to cover costs over a number of years, taken together. This raised at least two issues. First, there was the rather undemanding nature of the financial requirement. Second, there were no clear sanctions for failure to achieve 'adequate' returns (and, unlike with privatised industries, no threat of a takeover).

5 How did the nationalised industry control framework evolve to deal with the identified problems?

What is implied in the above section is that political control of SOUs entailed quite a long chain of accountability. Links in that chain ran from voters to MPs to Ministers and then (via instruments of varying degrees of effectiveness) to the boards of the public corporations. During the 40+ years of nationalised utilities which ran from the 1940s, there were various attempts to modify at least two of those links, those relating to the link between MPs and Ministers (and, to some extent and at the same time, the links between MPs and the boards of the public corporations) and those relating to the link between ministers and the boards - as well as to address the issue of the underlying incentives on the industries to improve their operational and financial performance.

Parliamentary accountability/scrutiny

At least in part, the creation of the public corporations, with their high degree of independence from direct political control, reflected earlier experiences with industries being run directly by government departments. In the words of Coombes, "The activities of state departments during the First World War, when a number of undertakings were temporarily taken under public control, had left most observers unfavourable towards state-departmental management"²⁹. However, as Coombes went on to say,

*"... as the [nationalisation] statutes began to take effect, the reality of what had been done began to dawn, with agonising results in some cases. While Conservative and Liberal Members had been opposed to making nationalised industries state departments for fear of extending the power of the bureaucracy; and while they had been anxious to give the boards of the nationalised industries independence in commercial matters, thus retaining at least some of the 'benefits' of private enterprise; they now found that these two vital interests clashed with an equally vital third one - their desire to keep the nationalised industries under surveillance"*³⁰.

²⁸ *ibid.*, p. 1047

²⁹ Coombes, David (1966), 'The Member of Parliament and the Administration', George Allen and Unwin Ltd, p.38.

³⁰ *ibid.* p. 41

Out of this angst, eventually (in 1956 and after several false starts³¹) came the Select Committee on Nationalised Industries which gave a forum for MPs to practice that surveillance. However, both the value of, and constraints on, the Select Committee were summed up in the following passage from Coombes.

"... to a major degree, the Committee was successful because it heeded the warnings of Lord Morrison and others about the nature of management in nationalised industries [i.e. it was for management to run the industries]. The Committee showed respect for the statutory independence and the commercial nature of the boards in the timing and range of its inquiries, in the emphasis it placed in its reports and the methods it adopted for undertaking inquiries. Thus it did not conduct efficiency or financial audits, nor did it attempt to suggest what sort of services the boards should provide. At the same time, it made a vital contribution to the accountability of the nationalised industries. As a Select Committee of Parliament, it was particularly well placed to investigate the relationship between Ministers and boards. In addition, the Committee provided a comprehensive survey of the work of the management of each industry and collated, in the appendices to its reports, a host of technical and statistical papers of great value. The efficiency of the management of the nationalised industries can be assessed much more reliably as a result of the Committee's reports."³²

From 1979 onwards, the whole system of Select Committees was revamped along government departmental lines and with enhanced powers of interrogation for the committees - thus facilitating, inter alia, more transparency about the performance of the nationalised utilities but without creating the capacity for auditing the efficiency of the industries.

Ministers and boards

However, it was always intended that any political control of the nationalised industries would be exercised not by MPs but by ministers. Just how problematic this became was spelled out at greatest official length in the 1976 report by the National Economic Development Office (NEDO), already referred to in Section 2 above³³. According to NEDO, there was:

- a lack of trust and mutual understanding between those who run the nationalised industries and those in government (politicians and civil servants) who are concerned with their affairs;
- confusion about the roles of boards, ministers and Parliament, resulting in blurred accountability;
- no systematic framework for reaching agreement on long-term objectives and strategy - and no assurance of continuity when decisions were reached;
- no effective system for measuring of nationalised industries or assessing their managerial competence.³⁴

³¹ "... it must be remembered that it took at least four years to set up the Committee; three Select Committees, two Parliamentary debates in Government time, and numerous Parliamentary Questions were occupied in its creation." *ibid.* p. 63

³² *ibid.* p. 204

³³ National Economic Development Office (1976), *Op. cit.*

³⁴ *ibid.* p. 8

In some ways, the NEDO report occupies a similar position in the post-war history of nationalised utilities to that of the later Principles for Economic Regulation³⁵ in the privatised utility period. In particular, both documents tried to recognise the reality of the political salience of utilities and the need to accommodate the desire of politicians to be involved in the running of these industries, while preserving independence from day-to-day political intervention. As expressed in the NEDO report

"... the fact is that Ministers in Britain are continually subjected to short term pressures from many quarters and an elected government often feels obliged to respond to such pressures. Proposals which ignore this are not likely to bring any lasting benefit."³⁶

NEDO's core proposal to address the central conflict between political salience and the desirability of day-to-day managerial independence was to interpose another layer of governance between Ministers and the public corporation boards in the form of 'Policy Councils'. The function of these Councils - with an independent President and membership to include representatives of Government, relevant trades unions and the executive management of the corporation in question - would be to:

- agree corporate objectives;
- agree strategic policies needed to achieve these objectives;
- establish performance criteria;
- endorse corporate plans, including annual budgets and related pricing and cost assumptions;
- monitor performance, at appropriate intervals, against pre-determined policies and criteria.³⁷

NEDO's thinking seems to have been that a Policy Council would do something to address the information asymmetry between Government and a corporation board, as well as providing some sort of firebreak between ministers and boards, albeit that ministers would appoint the Presidents of the Councils and some of the Council members, and would have to approve other members.

The Government did not accept the proposal for Policy Councils and indeed, by the time of the main privatisations, not a lot had changed in terms of the core relationship between ministers and boards from that which evolved in the 1940s and early 1950s.

Incentives for improved financial performance

As already noted, the original nationalisation statutes broadly required the public corporations to cover their costs over a number of years. At various times during the nationalised era, there were efforts by the Treasury to sharpen the pressures on the corporations to improve their financial performance, notably through a series of White Papers in 1961, 1967 and 1978³⁸. These varied in

³⁵ Department for Business, Innovation and Skills (2011), 'Principles for Economic Regulation', April. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/1-795-principles-for-economic-regulation.pdf

³⁶ *ibid.* p. 9

³⁷ *ibid.* p. 46

³⁸ HM Treasury (1961), 'Financial and Economic Obligations of the Nationalised Industries'. HM Treasury (1967), 'Nationalised Industries: A Review of Economic and Financial Objectives'. HM Treasury (1978), 'The Nationalised Industries'.

their precise focus (for example, as between overall rates of return, the appraisal of individual investment projects/programmes, pricing, and limits on external financing).

However, Vickers and Yarrow suggest that the 1978 White Paper *did* herald a general (and, to some extent, effective) tightening of the financial regime within which the nationalised industries operated. Not only did the Paper focus on ex post overall rates of return which could be monitored relatively easily (rather than on, for example, the ex ante rate of return on individual projects), it also required the industries to publish a series of performance indicators (for example, on unit costs and productivity) that could be used by sponsoring government departments to assess efficiency.³⁹

In addition, the post-1978 financial regime for the industries saw an increasing focus on the 'external financing limits' (EFL) of the industries. Overall, the reduction in the deficits of the public corporations fell from an average of around 16% (of the corporations' contribution to GDP) during the years 1970-1978 to an average of around 5% in the period 1979-1985⁴⁰.

Efficiency

As noted in Section 4, there was little in the initial plans for nationalisation about creating mechanisms to ensure or improve the efficient operation of the industries - more an assumption that a mixture of consolidation (and the realisation of economies of scale) and the act of nationalisation itself would achieve efficiency. As also already noted, the realisation that this would not necessarily be the case had already dawned in the 1940s. In response to this realisation, and according to Chester, "The Lord President [Morrison] favoured the device of an efficiency unit common to the various industries and appointed by them."⁴¹ At a meeting with the Chairmen of various public corporations on 3 May 1948, Morrison "stressed that just because Government were taking a firm line against interference by Parliament in the day-to-day management of the industries this should not obscure the fact that Parliament would take a sustained interest in the efficiency of the undertakings and would have the last word as to how that efficiency was to be tested"⁴². The response of the Board Chairmen was, not surprisingly, unenthusiastic and the idea of an efficiency unit died, albeit that some of the considerations which had led Morrison to propose it eventually underpinned the setting up of the Select Committee on Nationalised Industries - whose brief, however (and as already noted), stopped short of doing efficiency audits.

As also noted above, the nationalised industries were put under more pressure by the tighter financial regime which followed on from the 1978 White Paper and increased government focus in the 1980s on the industries' financial deficits.

In addition, two types of policy innovation from the same period were implemented to increase pressure to improve efficiency. These were:

- the provision in the 1980 Competition Act for the Monopolies and Mergers Commission (MMC) to conduct efficiency audits of the nationalised industries; and
- attempts to introduce competitive pressures into what were otherwise monopoly industries - for example, the 1982 Oil and Gas (Enterprise) Act in relation to gas supply and the 1983 Energy Act in relation to electricity supply.

³⁹Vickers and Yarrow (1988), Op. cit., p. 133

⁴⁰ *ibid.*, Table 5.5, p. 144

⁴¹ Chester (1975), Op. cit., p. 960

⁴² *ibid.*, p. 961

The MMC and Competition Act (1980) investigations of the nationalised industries

As noted above, the only systematic Government/Parliamentary scrutiny of the efficiency of the operations of the nationalised industries was that undertaken by the Select Committee on Nationalised Industries. However, it was also noted that, although the Committee provided a significant amount of information about the operations of the industries, neither it nor any other Government/Parliamentary agency conducted efficiency audits.

With the enactment of the Competition Act 1980 (more than thirty years after Morrison's proposal for an Efficiency Unit for the public corporations), the MMC was empowered to do this - and indeed went about doing this with some enthusiasm. In the years 1983 and 1984 alone, the entities examined included the Yorkshire Electricity Board, the National Coal Board, the London Electricity Board, the Yorkshire Water Authority, the Post Office, the South Western Electricity Board and the London Transport Executive. Given the effort that the nationalised industries had previously put into resisting assessment of their efficiency - for example, the (successful) resistance to Morrison's proposal of an Efficiency Unit - it would be hard to conclude that the threat of an MMC inquiry would not provide something of a spur to improved efficiency, regardless of the MMC's conclusions or of any ministerial action in the wake of those conclusions.

However, it is notable, at least in some of the MMC's reports, that the Commission seemed much more comfortable with criticising performance in areas within the comfort zone of government economists than in tackling the nuts and bolts of 'internal efficiency'. Thus, the Commission's 1981 report on the CEGB criticised (quite trenchantly) the corporation for its demand forecasting and appraisal of investment in new power stations, while being quite accepting of the CEGB's performance in areas like internal cost control, management information systems and methods of stock control (although the Commission was highly critical of the cost and time taken to construct new power stations).⁴³

Oil and Gas (Enterprise) Act 1982 and Energy Act 1983

On the basis that what really motivates a monopoly to improve its performance is the threat of competition, the 1980s also saw government attempts to increase competitive pressure on the monopolistic nationalised industries. The Oil and Gas (Enterprise) Act 1982 was, inter alia, intended to facilitate gas being supplied by suppliers other than the British Gas Corporation, at least to relatively large industrial consumers. The Energy Act 1983 was similarly designed to, inter alia, facilitate Area Electricity Boards purchasing electricity from generator/suppliers other than the Central Electricity Generating Board (CEGB).

Neither of the Acts achieved much in the way of stimulating competitive supply. As noted by Vickers and Yarrow, "The CEGB's response to the Energy Act was to restructure the BST [the Bulk Supply Tariff, the wholesale price charged by the CEGB to the Area Board electricity retailers] in a way that compelled the Area Boards to offer less favourable terms to private producers than to the CEGB"⁴⁴. Vickers and Yarrow also concluded that the Oil and Gas (Enterprise) Act "had no discernible impact on the degree of competition in the U.K. gas industry"⁴⁵.

Although they suggested several reasons for the failure to produce more competition in the electricity and gas industries, the underlying thread is the way that incumbents could tailor their offerings (whether in terms of prices to contestable consumers or in the terms offered to putative competitors) - and to do this without triggering regulatory intervention. This failure to stimulate

⁴³ Monopolies and Mergers Commission (1981), 'Central Electricity Generating Board', HMSO, pp. 285 - 293

⁴⁴ Vickers and Yarrow (1988), *Op.cit.*, p. 292

⁴⁵ Vickers and Yarrow (1988), *Op.cit.*, p. 258

competition to the state-owned monopolies lay at the heart of measures taken at or after the privatisation of some of the industries in question - including tightening up of non-discrimination conditions in the licences of incumbents and separating the ownership of networks from the ability to supply over those networks, as well as through statutory obligations on independent utility regulators to promote competition.

Overall effectiveness of the changes in the framework within which the nationalised industries operated and the question of whether more could have been done to make the public corporations more effective

In trying to sum up the changes summarised in this section, it is clearly not the case that the framework for controlling the nationalised industries did not evolve. Not only did the framework evolve but some of the changes did, at least to some extent, remedy deficiencies in the initial framework.

- The Select Committee on Nationalised Industries (and, after it, the more general revamp of the Select Committee system which happened in 1979) ensured more Parliamentary visibility (and, to a degree, more Parliamentary accountability) of the working of the public corporations.
- The eventual increased focus on ex post rates of return and on financial deficits improved the financial performance of the corporations, as a whole, as well as probably providing a degree of pressure on the operating efficiency of the companies.
- The enhanced role of the MMC in relation to the public corporations, which came with the 1980 Competition Act, almost certainly did provide a spur to improved efficiency, even though the spur to efficiency may have been somewhat blunted by a lack of operational expertise within the MMC, as well as by a lack of mechanisms to ensure that the Commission's conclusions were acted on by the corporations.

However, what was identified as the central problem in the political control of the nationalised utilities - the relationship between ministers and the boards of the public corporations - remained unresolved, as indicated by the 1976 NEDO report, as well as by the failure to make significant changes to the relationship in the light of that report. According to Vickers and Yarrow,

"The fact that nearly 30 years after deficiencies in the framework of accountability and control were first recognised, little progress had been made in resolving substantive issues concerning the respective roles of the management boards, ministers and Parliament became, in the late 1970s, a major source of dissatisfaction with Government policy towards the public corporations. The effect of this failure was to buttress the case for privatisation: given that the flaws in the arrangements had proved so difficult to correct, it could more easily be argued that progress in solving the underlying problems required a radical shift in the relationship between Government and the enterprises concerned, and that the transfer of ownership to the private sector was the most direct method of achieving the desired adjustment."⁴⁶

The limited effectiveness of the changes in the political control framework for nationalised industries begs the question of whether things could have been done differently to make the changes more effective. In their book on privatisation, Vickers and Yarrow concluded that things could have

⁴⁶ Vickers and Yarrow (1988), Op. cit., pp. 129 - 130

worked out differently: more competitive pressure on the state-owned monopolies; specialised regulatory agencies responsible for price controls and the promotion of competition; a specialised agency for conducting efficiency audits; more widespread use of performance-related incentives for public corporation managements⁴⁷.

However, even if things could, in principle, have been done differently, the important question (as implied by the above quote from Vickers and Yarrow) is why they were not, especially given that there was no shortage of analysis on what was wrong with the way things were actually being done, particularly in respect of the relationship between ministers and the boards of the public corporations, going back to the years immediately following the main nationalisations. As already noted, there was the exhaustive analysis of the problem by NEDO in 1976 but, before that, there had been, for example, the Herbert Committee on the Electricity Supply Industry in 1956.

In trying to provide a hard border between the roles of ministers and boards, this committee recommended that the sole purpose of the electricity supply industry should be to generate and distribute electricity as cheaply as possible - and the industry alone should be responsible for decisions on how to do this. National interest considerations (cross-subsidisation of rural customers or restricting equipment tenders only to UK suppliers, for example) should be regarded as political matters to be decided by the Minister. In other words, there should be a more formal and transparent division between the commercial and the political - and the intrusion of the political should, at the very least, be transparent (which would have facilitated Parliamentary and other debate).

The Government rejected the Committee's proposals and, for W.A. Robson, there was no great mystery as to why this was. "Mr D.N. Chester has put his finger on a very soft spot when he writes that all governments try to get their own way without being held responsible for the results".⁴⁸ Instead, for Robson, rather than being prepared to face up to their responsibilities (for intervention without a formal Direction), ministers preferred to live in the 'twilight zone', "... flitting happily from one private meeting to another, talking things over with the chairman at lunch, in the club, in the House of Commons, in the department, without disclosing either to the public or to Parliament the real extent of their intervention"⁴⁹.

Therefore, any proposals for how political control of SOUs might work better in the future than in the past have got to accommodate the simultaneous desire of politicians to influence the actions of the industries and their frequent unwillingness to take responsibility for the outcomes of those actions, especially if those outcomes were likely to be unpopular. But, before trying to conclude on how the future political control of state-owned utilities could work better than in the past, including in the context of how politicians actually behave, the following sections look at what, if anything, can be learned from how political control of utilities has worked since the main utility privatisations.

6 What lessons can be learned from the regulation of the privatised utilities?

The theory

In looking for what lessons can be learned from the regulation of the privatised industries, it can initially be noted that the framework for the economic regulation, as it has now evolved, has tried to address some of the issues with the previous nationalised industry framework of control. Specifically, most of the utility regulatory regimes (for the monopoly parts of the industries, which

⁴⁷ *ibid.* p. 151

⁴⁸ D.N. Chester (1956), 'The Nationalised Industries', Three Banks Review, December, pp. 42 - 43, quoted in Robson, William A. (1962), 'Nationalised Industry and Public Ownership', Second Edition, p. 147

⁴⁹ *ibid.* p. 162

are the main focus of the Labour Party's renationalisation proposals) have evolved elaborate incentive structures for delivering desired outcomes more efficiently. These are embodied in a whole variety of 'outcome delivery incentives', notably for the water industry and for the energy networks, as well as in the basic efficiency discipline of having 'base' revenues determined for future periods. In terms of any lessons here for future nationalisations, it has, of course, to be noted that the power of these incentives is sharpened by their potential impact on the profits of the companies involved, and thence on the dividends of shareholders, a feature which would not be replicated in the event of renationalisation.

However, probably the more important and more general issue for the political control of SOUs is the institutional framework put in place for the regulation of privatised utilities and what, if any, lessons this has for political control in the event of future renationalisations. As noted in the earlier sections the core issue with the political control of the nationalised industries was the (effectively unresolved) tension between the desire of ministers to influence industry outcomes (and their desire often to do this without their role becoming public) and the desirability of allowing the boards of the public corporations to get on with at least day-to-day operational management without political interference.

The would-be solution to this tension in the privatised world has been the creation of 'independent' regulators. In principle, these ministerial agents would look to solve some of the principal-agent/minister-board tensions from the nationalised era.

- For a start, regulators can be the sort of firebreak between ministers and the utilities which had been the role envisaged by NEDO, back in 1976, for the Policy Councils. In part, this is about resolving the time inconsistency issue, often given as a rationale for this sort of delegated governance⁵⁰. Independent agencies (like, for example, the Bank of England), operating within an appropriate statutory framework, enhance the credibility of promises made by government by giving some assurance that certain future decisions will not be governed by day-to-day politics.
- Second, as was also envisaged for the Policy Councils, specialist regulators can help to address the information asymmetries which otherwise exist between ministers and utility managements. This is, at least in part, because mainstream civil servants (especially the most talented and ambitious) rarely stay in one job long enough to accumulate substantial knowledge of a particular area. Even though regulatory agencies often themselves have high turnover, staff quite often move between regulatory bodies and continue to accumulate expertise relevant to regulating a particular sector. Currie (who had experience as Chairman of both Ofcom and the Competition and Markets Authority) wrote that it would be wrong to overstate this point, but also stated that "the typical career development with the central civil service is one of rotation from one area to another, and therefore tends to favour general administrative skills over technical skills. An independent regulator may well be able to attract and retain a stronger body of technical specialists, with benefits for the quality of regulation"⁵¹.
- Third, economic regulators have, at least over time, developed considerable transparency about the basis for regulatory decisions. A typical periodic review of price controls for monopolistic utilities will generate a large amount of economic, financial and technical

⁵⁰ See, for example Currie, David (2014), 'The Case for the British Model of Independent Regulation 30 Years on', Currie Lecture given at Cass Business School on 21 May, <https://www.gov.uk/government/speeches/the-case-for-the-british-model-of-independent-regulation-30-years-on>

⁵¹ *ibid*

material which is published on the regulators' websites. This not only helps with the issue of Parliamentary accountability but also assists with visibility to all stakeholders and establishes a degree of pressure on regulators to make decisions which can be publicly defended, rather than simply being a response to (possibly informal) ministerial pressure, and thus on average contributing to 'better' decisions.

- Fourth, the ability of regulators' decision to be appealed to another body (for example, the Competition and Markets Authority or the Competition Appeals Tribunal) places additional pressure to reach defensible decisions, again rather than simply responding to pressure from ministers.

These, then, are some of the theoretical benefits of having independent regulators, some of which could, in principle, be carried over into the political control regimes for future state-owned utilities. But, even before trying to answer the question of whether independent regulators (or some other, differently labelled form of independent agency) could help mitigate the tension between political salience and the efficiency of renationalised utilities, it is worth asking how sustained has been the independence of regulators in the privatised era, given the inevitable desire of politicians to want to interfere with that independence in the interests of achieving objectives of their own. To this end, the following questions are posed.

- What did independence mean in practice in the early period after the main privatisations?
- How has this independence evolved since then?
- Does it still have value in reconciling political salience and efficiency?
- What, if anything, does this imply for the political control framework which could be adopted for future utility renationalisations?

7 The meaning of regulatory independence in the early post-privatisation period

There is at least a case to be made that, in the period immediately after the main privatisations (through the 1990s), independent regulation meant something at least close to its literal meaning. It is, of course, true that regulators (as with the boards of the public corporations) were (and are) appointed by ministers. It is also true that the statutory obligations on regulators can be changed by Parliament (and it is also now true - but this was later - that powers exist for ministers to give regulators 'guidance', additional to their statutory obligations).

However, within these parameters and in this period, regulators do seem to have been fairly free from the sort of informal ministerial pressures which characterised the nationalised industry era. The author interviewed Professor Stephen Littlechild (the first electricity industry regulator) and Claire Spottiswoode (the second gas industry regulator) on this question. Both confirmed that, during their tenures, there was no significant ministerial pressure to take particular decisions. Professor Littlechild also emphasised that, for example, the two big Office of Electricity Regulation (Offer) policies in this period (to require the incumbent generators to divest generating plant and to reform the trading arrangements for wholesale electricity) were initiated by Offer and not by ministers.⁵²

There are probably several reasons why regulators had considerable autonomy in this period.

- First, this period was soon after the flotations of the energy and water industries and, for at least part of the period, in advance of the privatisation of the rail industry. In these

⁵² Author interview with Stephen Littlechild, 16 February 2016. Interview with Claire Spottiswoode, 29 April 2016

circumstances, there might well have been a reluctance in the Government to do anything which might have upset shareholders in the privatised industries, especially as there was then still a reasonably high proportion of small investors holding the shares, many of them persuaded to buy the shares by extensive Government advertising campaigns. In addition, there may have been a desire not to prejudice the proceeds from future privatisations.

- Second, at least the *primary* statutory obligations on regulators like the energy regulators, were fairly straightforward and, crucially, not self-contradictory (and, therefore, not entailing the need for 'political' trade-offs between objectives). In the case of electricity, for example, the primary obligations were to: secure that all reasonable demands for electricity demand were met; secure that licence holders could finance their activities; and promote competition in generation and supply⁵³.
- Third, the above factor partly reflected the fact that, there was no wider political agenda at the time likely to involve politicians leaning on regulators to take a particular line and choose in a particular way between conflicting objectives (as was later the case once, for example, the environment/climate debate intensified). The more complicated obligations of the Utilities Act 2000 (and the Water Act 2003), including the rebalancing of objectives between investors and consumers, were also yet to come into force. In so far as there was a dominant ideology, at least for the duration of the Conservative Government, it was to rely on markets to deliver good outcomes - a position articulated earlier (and in relation to the energy sector) in a much-quoted speech by Nigel Lawson.

*'I do not see the government's task as being to try to plan the future shape of energy production and consumption. It is not even primarily to balance UK demand and supply for energy. Our task is rather to set a framework which will ensure that the market operates in the energy sector with a minimum of distortion and energy is produced and consumed efficiently.'*⁵⁴

- Fourth, at least in the energy sector, there was a relatively favourable macroeconomic context in this period. In particular, world oil prices (which tend to influence the price of fossil fuels, and therefore, wholesale and retail energy prices more generally), had fallen sharply in the mid 1980s and stayed relatively low (averaging around \$20/barrel) through into the early 2000s. This tended to reduce the political salience of retail electricity and gas prices and the temptation of politicians to exert pressure to hold down retail prices.

So, in sum, the circumstances of the 1990s and early 2000s were rather favourable to regulators being left to get on with regulating. In this world, independent regulators seemed a rather effective way of reconciling political salience with efficiency.

However, this did not mean that regulatory independence, as practised in the early post-privatisation period was sustainable: the flotation price motivations were always likely to fade once the main sell-offs had been achieved; the long-term history and economics of the oil industry implied that oil prices, and thus retail energy prices, would not stay low indefinitely; and the 1990s look, in retrospect, rather an unusual period in terms of ministerial willingness to play a hands-off

⁵³ Electricity Act 1989, Section 3

⁵⁴ Speech by Nigel Lawson 'The Market for Energy', given the Fourth Annual International Conference, International Association of Energy Economists, Churchill College, Cambridge, 28 June 1982. Quoted in Helm, D. (2003), 'Energy, the State and the Market: British Energy Policy since 1979', Oxford University Press, pp. 57 – 58. Reproduced in Helm, D., Kay, J., Thompson, D (eds) (1989), 'The Market for Energy', Oxford: Clarendon Press.

role in various areas of economic activity (a phase which also contained the Enterprise Act 2002's reduction of the role of ministers in approving mergers).

8 How has regulatory independence evolved since the 1990s? The case of Ofgem

Since the 1990s, delegation by Government/Parliament to regulators has become quite a bit more complicated, albeit in some sectors more than others. The energy sector has been a particular battleground between ministers and the regulator. The water sector has (at the time of writing) been undergoing something of a political baptism of fire, not least around performance and financial engineering issues, but this has not seen any obvious breach between the Government and Ofwat - both seem rather well aligned in trying to restore some sense of legitimacy to the privatised industry.⁵⁵ In the telecoms industry, the Government's desire to hit physical targets for fibre optic broadband connections is reminiscent of earlier ministerial preoccupations with hitting physical targets for renewable electricity generation (a prime source of discord with Ofgem, see below) but, again, the issue does not seem to have caused overt signs of the Government trying to curb or subvert the independence of Ofcom, not least because Ofcom seems to believe that regulatorily assisted competition can lead to a substantial roll-out of fibre optic cable⁵⁶. In his history of UK telecoms regulation, Cave concluded that Ofcom has been genuinely independent⁵⁷.

It is, therefore, worth focusing on the energy sector when looking at whether independent regulation offers a sustainable mechanism, even in the face of somewhat intense minister-regulator conflict, for mitigating the tension between political salience and the desirability of utilities (and their regulators) having a reasonable degree of operational independence.

At the risk of some oversimplification, the tensions between ministers and Ofgem arose for two main reasons. First, the long period of low oil prices which ran from the mid-1980s to the early 2000s came to an end. This underlay an increase in wholesale gas and electricity prices and, in turn, meant higher retail prices and increased political salience of the sector.

Second, and probably more important, the Government's broader agenda for the energy sector changed markedly. In the post-privatisation period, policy had been largely about promoting competition in both generation in electricity and in supply (i.e. retailing) of both gas and electricity. Thereafter, Government energy policy became much more focused on the climate change agenda and, in particular, on reducing carbon emissions from electricity generation. This focus was underpinned by:

- the 2003 Energy White Paper which set out four objectives for energy policy: reduce carbon emissions; maintain the reliability of energy supplies; promote competitive energy markets; and ensure that every home is adequately and affordably heated⁵⁸;

⁵⁵ Michael Gove (2018), 'A water industry that works for everyone', 1 March, <https://www.gov.uk/government/speeches/a-water-industry-that-works-for-everyone>. Jonson Cox (2018), 'Jonson Cox (2018), 'Speech at Water Industry City Conference', 1 March, <https://www.ofwat.gov.uk/wp-content/uploads/2018/03/Jonson-Cox-speech-at-Water-City-UK-1-March-2018.pdf>

⁵⁶ See for example, Ofcom Statement at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/1-795-principles-for-economic-regulation.pdf

⁵⁷ Cave, M. (2016), '40 Years On: An Account of Innovation in the regulation of UK Telecommunications, in 3^{1/2} Chapters', *Telecommunications Policy*, 41(10), pp. 904 - 915

⁵⁸ Department of Trade and Industry (2003), 'Our Energy Future - Creating a Low Carbon Economy', February, pp. 12 - 15.

- the Climate Change Act 2008 which required the Secretary of State to ensure that specified greenhouse gas emissions should, by 2050, be at least 80% below a 1990 baseline;
- the 2009 EU Renewable Energy Directive which required the UK (and other EU member states) to achieve specified targets for renewable electricity generation.

The conflict between the then Department of Energy and Climate Change (DECC, since incorporated into the Department of Business, Energy and Industrial Strategy, BEIS) and Ofgem therefore revolved around DECC's desire to increase the amount of renewable energy generation and Ofgem's interpretation of its statutory obligations. Since the Utilities Act 2000, Ofgem's primary duty had been to protect the interests of (present and future) consumers and Ofgem interpreted this duty as, at least in part, being about keeping retail energy prices down at a time when renewable generation was substantially more expensive than gas and coal-fired generation.

Although much of the conflict between ministers and regulator was conducted behind closed doors (thus echoing the informal pressures of the nationalised era), it did surface from time to time, as with, for example, the (to anyone outside the electricity industry of the time) somewhat arcane Transmission Access Review. This was primarily about whether new wind generation (especially in Scotland) should be allowed to connect to an electricity transmission system which had insufficient capacity to accommodate it (at least at certain times) - with the consequence that electricity consumers would end up having to compensate the said generators for not being able to generate (and earn revenue from that generation).

Bearing in mind its duty to protect the interests of consumers, Ofgem favoured delaying or rationing connection of the relevant generation⁵⁹. DECC, on the other hand and with its objective of increasing renewable generation, favoured connecting the generation, regardless of its ability to generate at all times⁶⁰. In the end, DECC simply used its own statutory powers to push ahead with allowing the generators to connect, regardless of the available relevant capacity on the transmission system.

Anyone looking for further public evidence of the conflict between DECC and Ofgem also needs to look no further than the 'Review of Ofgem' which DECC published in 2011 and which could be characterised as something of a howl of frustration at DECC's past inability to get Ofgem to do what it (DECC) wanted.

'Previous attempts to improve the alignment of the regulatory framework with Government strategy have included amendments to the duties ... and the introduction of the Social and Environmental Guidance through the Utilities Act 2000. However, these have not succeeded in consistently and transparently achieving the desired coherence between the overarching strategy and the regulatory regime.'

This disconnect can be attributed to two characteristics of the existing legal framework: the broad scope of the duties and the weak legal status of the

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/272061/5761.pdf

⁵⁹ Ofgem (2009), 'Ofgem's Response to DECC's Consultation on "Improving Grid Access"', 8 December. <https://www.ofgem.gov.uk/sites/default/files/docs/2009/12/decc-consultation-response.pdf>

⁶⁰ Department of Energy and Climate Changes (2010), 'Government Response to the Technical Consultation on the Model for Improving Grid Access', 27 July. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/42979/251-govt-response-grid-access.pdf

Guidance. The duties describe the statutory boundary within which the regulator must make its decisions and are intentionally broad to allow the regulator flexibility and, therefore, space to ensure long-term stability. However, because of their broad nature, the regulator is given considerable scope for interpretation, which could result in poor alignment between the regulator and the Government's views.⁶¹

The conflict between DECC and Ofgem mirrored the mode of ministerial intervention in nationalised industries in a variety of ways.

- Much of it did involve informal pressure, as implied by DECC's Review of Ofgem, thus making it more difficult for it to be scrutinised by Parliament or others.
- Ministers were reluctant to be seen to be directly pushing policies which increased prices to consumers and DECC itself persistently downplayed the impact of expanding renewable generation on the retail price of electricity⁶² and, therefore, the existence of a trade-off between climate change policies and prices to consumers.

This unwillingness to take ministerial responsibility for potentially unpopular trade-offs was nowhere more clearly set out than in the then Department of Trade and Industry's 2004 'Social and Environmental Guidance' to Ofgem (DECC was not created until 2008).

'The Government has not sought to rank the four objectives set out in the White Paper ["achieve carbon reduction targets, maintain reliable supplies, promote competitive markets, ensure that every home is adequately and affordably heated"]. It is the Government's view that these objectives can be achieved together and the Government has put in place policies designed to achieve this.⁶³

At the time that this Guidance was published, the gap between the cost of renewable electricity (dominated, then as now, by the cost of offshore wind generation) was large - and it was obvious at the time that any policies to encourage/subsidise low-carbon generation would raise retail electricity prices and therefore reduce the affordability of electricity.

There were various results of this conflict between the Government and Ofgem.

- First, the Government effectively shrank Ofgem's responsibilities in the main area of contention, i.e. the expansion of low-carbon electricity generation. Whereas previous market changes (like the so-called New Electricity Trading Arrangements) had been initiated and implemented by Ofgem, DECC itself initiated and implemented the so-called Electricity Market Reform which ultimately involved Government (through a new agency, the Low

⁶¹ Department of Energy and Climate Change (2011), 'Ofgem Review: Final Report', July, p. 24.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/48134/2151-ofgem-review-final-report.pdf

⁶² See, for example, Department of Energy and Climate Change (2013), 'Estimated Impact of Energy and Climate Change on Energy Prices and Bills', March.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/172923/130326_-_Price_and_Bill_Impacts_Report_Final.pdf

⁶³ Department of Trade and Industry (2004), 'Social and Environmental Guidance to the Gas and Electricity Markets Authority', February

Carbon Contracts Company) entering into long-term contracts for new low-carbon generation.

- Second, the Government got much more involved in other (energy network) issues which had hitherto been the exclusive responsibility of the regulator. The Government's decision on network access for wind generators (covered above) was one instance of this.
- Third, there were successive changes to Ofgem's statutory obligations, especially in the Energy Act 2010, to make it more explicit that the interests of consumers included their interest in decarbonisation, as well as in security of supply. However, the Act itself stops short of giving guidance to Ofgem on how it should make trade-offs between affordability, decarbonisation and security of supply (the so-called 'Energy Trilemma'). In effect, Government energy policy at the time had, as its primary objective, to hit targets for new renewable generation and, as its secondary objectives, to minimise the cost of this to consumers and mitigate the effects on security of supply of electricity resulting from the intermittency of much renewable generation. However, the Government was not prepared to be explicit about this prioritisation of objectives, presumably because it would then be clearer than it already was that Government energy policy involved putting up electricity prices.
- Fourth, DECC, in its review of Ofgem, did accept the principle of Strategy and Policy Statements, proposed in an earlier Government paper, 'Principles for Economic Regulation'⁶⁴. In effect, such Statements were envisaged to be a more binding version of Social and Environmental Guidance, and were legislated to be such by the Energy Act 2013. Such a Statement would have been the obvious conduit for the Government to spell out its energy priorities and how it wanted different objectives to be traded off against each other by Ofgem. However, even though the Government published a Draft Strategy and Policy Statement⁶⁵, it was never finalised. This is unlike in the water sector, where Ofwat does have such a Statement, and unlike in the rail sector, where the Department for Transport informs the Office of Rail and Road (ORR) what it wants from rail activities through its 'High-Level Output Specification' (HLOS), as well as informing ORR what money is available, reflecting the Government's role in funding the work of the state-owned Network Rail. Thus, throughout the period when renewable generation was much more expensive than generation from gas-fired power stations, the Government avoided spelling out its actual policy priorities and, thence, the policy agenda which it wanted Ofgem to implement - just as ministers in the nationalised era had been reluctant to give formal Directions to the boards of the nationalised industries.

In sum, the Government had no shortage of opportunities to spell out in a public and transparent way what it actually wanted Ofgem to do, especially once it had amended Ofgem's statutory obligation in the 2010 Energy Act - but it failed to do so. In a more recent conflict with Ofgem, over the imposition of price controls on retail gas and electricity, the Government has been prepared to engage in a public exchange with Ofgem⁶⁶ (as well as to introduce legislation to empower Ofgem to

⁶⁴ Department of Business, Innovation and Skills (2011), Op.cit

⁶⁵ Department of Energy and Climate Change (2014), 'Strategy and Policy Statement: A consultation on the draft statement', August.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/343314/SPS_consultation_paper_.pdf

⁶⁶ Parker, George (2017), 'Greg Clark tells Ofgem to rein in power companies', Financial Times, 29 September. References for the letters between Greg Clark and Dermot Nolan are at Footnote 73 below.

introduce the controls⁶⁷). However, before drawing much comfort from this, it should be noted that the Secretary of State was arguing for Ofgem to be tougher in pushing retail energy prices down (rather than previous conflicts which were about putting electricity prices up) - and that this is a rather more politically attractive position for a Secretary of State to be in.

Therefore, the case of Ofgem suggests that simply having a nominally independent regulator (or another sort of agency between government and the relevant utilities) is not, by itself, enough to prevent the sort of informal ministerial and non-transparent utility interventions which characterised the nationalised era and contributed to the failings of the nationalised industries.

9 In the light of the above, do independent regulators still have a value in reconciling political salience and economic efficiency of utilities?

In the light of the above, a pessimist (on the question of insulating utilities from day-to-day political intervention), could argue that the Ofgem case shows that, when the political heat is on (for example, because of a political desire to raise consumer prices to achieve other political objectives without having the politician's fingerprints directly on the price-increasing actions), regulatory independence has not meant very much - and has, therefore, not been an effective barrier to the sort of day-to-day and covert ministerial intervention in the operation of utilities which characterised the nationalised era.

However, there are other ways of looking at the history of the last decade or so in this area. It is arguable that:

- first, regulatory independence does not seem to have been such an issue in other sectors, at least within defined areas of activity; and
- second, it may well be that the lessons from the energy sector are not all quite what they seem at first sight.

Regulatory independence in non-energy sectors

In the telecoms sector, for example, Oftel and then Ofcom appear to have been broadly left to get on with protecting consumers' interests through a mixture of promoting competition and through regulation of the core BT network⁶⁸, most recently through the imposed legal separation of Openreach. It is notable that, when there has been an issue requiring a solution which the market was unlikely to deliver of its own accord - for example, the expansion of rural broadband - the Government chose to approach this issue through taxpayer-funded subsidy (and competitive auctions to minimise the cost of the subsidy), rather than (as with energy) through a levy on suppliers as a whole (and thus on customers as a whole). Thus, Ofcom was not required to confront a trade-off between its consumer protection obligations and wider objectives. It may also be significant that Ofcom has a primary duty to further the interests of those of 'citizens', as well as those of 'consumers'⁶⁹, thus giving Ofcom more flexibility than Ofgem, with its primary duty to protect the interests of consumers, especially before these interests were elaborated in the 2010 Energy Act (although also potentially requiring Ofcom to make more 'political' decisions).

It is, of course, arguable that telecoms has been a less politically charged area than energy, not least because the long-term trajectory of quality-adjusted prices has, unlike with energy, been downwards. It is also a fact that the subsidies which have been spent on rural broadband, for

⁶⁷ Domestic Gas and Electricity (Tariff Cap) Act 2018

⁶⁸ See, for example, Cave, M (2016), '40 Years on: An Account of Innovation in the Regulation of UK Telecommunications, in 3^{1/2} Chapters', Telecommunications Policy

⁶⁹ Communications Act 2003, Section 3(1)

example, are an order of magnitude less than those which have been spent on low-carbon energy, making it an easier political choice to go for taxpayer funding.

In the privatised water sector, there has always been a tension between meeting Ofwat's duty to protect the interests of consumers and, as with energy, broader environmental objectives. However, that tension has, to some extent, been institutionally formalised in the separate roles of Ofwat, the Environment Agency and the Drinking Water Inspectorate - with the result, that Ofwat itself is less faced than Ofgem with having to make judgements about what enhancements need to be made by the water companies to achieve broader objectives. In addition, the Government has implemented periodic Strategy and Policy Statements in the water sector, allowing it to give transparent guidance to Ofwat at discrete intervals on how it should be interpreting its statutory obligations, thus mitigating, at least in principle, the political need for more frequent and less transparent intervention.

It is true that political interventions in the water sector have been more obvious in the recent past, against the background of increasing questioning of the legitimacy of having the water industry in private ownership. But, it can also be noted that those interventions *have* been obvious, i.e. public, as with the March 2018 speech by Michael Gove⁷⁰ and do not look to have been pushing Ofwat to do anything which it would have not done anyway. Recent documents from Ofwat suggest enthusiasm for restoring political legitimacy in the sector⁷¹.

The value of political intervention being transparent has been emphasised by Currie when Chairman of the Competition and Markets Authority, in the context of the Government's Strategic Steer to the CMA, the CMA's own version of a Strategy and Policy Statement.

*'... legislation requires government to give the CMA a high-level strategic steer. Some have pointed to the strategic steer that Government gives us as a weakening of [the CMA's] independence. I could not disagree more strongly. It is important that any regulator, including the competition authority, is sensitive to both political currents and commercial realities. And it is important that there is a continued dialogue between the regulator and Government on a "no surprises, no veto" basis. The strategic steer makes that high-level communication, which might otherwise be covert, open and transparent.'*⁷²

In sum, in the telecoms and water sectors, regulators do seem to have been broadly left to get on with regulating their respective sectors, sometimes with 'guidance' on how they should be interpreting their statutory obligations, meaning that the industries themselves have had a degree of insulation from day-to-day political intervention.

⁷⁰ Michael Gove (2018), 'A water industry that works for everyone', 1 March.

<https://www.gov.uk/government/speeches/a-water-industry-that-works-for-everyone>

⁷¹ For example: Ofwat (2018), 'Putting the Sector Back in Balance: consultation on proposals for PR19 Business Plans', 26 April, <https://www.ofwat.gov.uk/wp-content/uploads/2018/04/Putting-the-sector-back-in-balance-consultation-on-proposals-for-PR19-business-plans.pdf> ; Ofwat (2018), 'Putting the Sector Back in Balance: Summary of Ofwat's Decision on Issues for PR19 Business Plans', 3 July, <https://www.ofwat.gov.uk/wp-content/uploads/2018/04/Benefit-sharing-decision-statement-FINAL-for-publishing.pdf>.

⁷² Currie (2014), Op. cit

A different take on the energy sector itself

Despite the narrative of Section 8 above, it is arguable that, even in the energy sector, the existing framework now gives energy companies quite a high degree of insulation from day-to-day political intervention.

- First, the conduct of network price reviews has been largely left for Ofgem to get on with them. Recent changes in this area - notably, the prospective squeezing of network rates of return - would look to be broadly explicable in terms of trends in capital markets, rather than a result of political pressure (even though there has also been significant muttering by various politicians and other NGOs, like Citizens' Advice, about the returns which energy networks have made, to date⁷³).
- Second, generators of low-carbon electricity are broadly insulated from political surprises by long-term contracts with the Low Carbon Contracts Company, a government entity. (In addition, returns to other generators, who may increasingly be required to generate only relatively infrequently as low-marginal cost low-carbon generation is expanded, are partly underpinned by contracts awarded under a market-based 'Capacity Mechanism', run by National Grid in its GB System Operator role.)

In other words, even though the scope of independent regulation in the energy sector has been narrowed by the Electricity Market Reform process, a combination of 'independent' regulation of energy networks and long-term contracts with government for new low-carbon generation (plus Capacity Mechanism contracts for other generators) is arguably an efficient solution to insulating the two, quite different activities (generation and networks) from day-to-day political intervention. Price controls, set every five years, work for energy networks because no-one knows what investment will be required in energy networks more than a few years out. In contrast, long-term contracts (normally, 15 years for renewable generators, longer for nuclear) are a more appropriate mechanism for underpinning returns of pre-defined activities like building and operating a particular low-carbon power station (albeit that the uncertainties around the construction of nuclear power stations are a continuing source of debate about how such contracts should work⁷⁴).

Even the recent example of political intervention on the subject of price caps for energy suppliers has not been as damaging as the process which caused such government-Ofgem conflict in the earlier period.

- It would seem to have been conducted, at least to a large extent, in public, with an exchange of letters between the Secretary of State and the Chief Executive of Ofgem⁷⁵ - resulting in new statutory powers for Ofgem which enabled Ofgem to impose a price cap.

⁷³ Citizens Advice (2017), 'Energy Consumers' Missing Billions: the profits gifted to energy networks', 12 July. <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/energy-consumers-missing-billions/>

⁷⁴ See, for example, Department for Business, Energy and Industrial Strategy (2019), 'RAB Model for Nuclear: Consultation on a RAB Model for New Nuclear Projects', July. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/825119/rab-model-for-nuclear-consultation.pdf?_ga=2.73179923.1248328113.1566907162-994177735.1565623872

⁷⁵ Letter from Greg Clark to Dermot Nolan, 21 June 2017. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/620993/greg-clark-ofgem-letter-21-06-17.pdf
Letter from Dermot Nolan to Greg Clark, 3 July 2017. https://www.ofgem.gov.uk/system/files/docs/2017/07/20170703_-_letter_from_dermot_nolan_to_the_secretary_of_state.pdf

- It followed on from the CMA's Energy Market Investigation⁷⁶, i.e. from the evidence provided by an independent competition authority. Even though the CMA's majority conclusion did not recommend a general price cap on retail energy prices (Professor Cave's dissenting opinion did, on the other hand, argue for a cap), the report did provide evidence which the Secretary of State drew on in reaching his conclusion.
- The price controls are also explicitly calculated (and recalculated every six months) by Ofgem to allow an 'efficient' supplier to earn a reasonable return - thus, again and in principle, giving energy supply a degree of insulation from direct political intervention (as has, in the past, been quite common in several other West European countries).

In sum

In sum, independent regulation would overall seem to have been helpful in encouraging political intervention in privatised utilities to have been transparent and mainly focused on achieving big strategic objectives (consistent with the Morrisonian vision for nationalised utilities), whether that be faster broadband connectivity in the telecoms sector, improved political legitimacy in the water sector or decarbonisation in the energy sector - or, in the case of the Strategic Steer to the CMA, a request to prioritise sectors where increased competition might be expected to have a real impact on GDP growth⁷⁷. Where there has been the more 'traditional' sort of political intervention, as with the pressure on Ofgem to cap retail energy prices, this was at least fairly transparent and was, at least to some extent, based on evidence compiled by the independent competition authority.

There is at least one major exception to this narrative - DECC's conflict with Ofgem in the period which led up to the DECC review of Ofgem's role in 2011. Without trying to ignore this example (which provides an important element in the argument in the following section), it can at least be said that the outcome of this period was a regime (a mixture of regulation and contracts with either the government itself or, as with the Capacity Mechanism, with the Electricity System Operator) which is eminently defensible as an efficient way of achieving the government's actual objectives (of boosting low-carbon generation, while mitigating the effects of this on energy affordability and reliability of supply), while keeping government out of the day-to-day operations of the industry.

Having said all of this, BEIS has chosen to not follow the recommendation of the DECC review of Ofgem to have a Strategy and Policy Statement in energy, even though the then Secretary of State did publish the (arguably not terribly helpful) 'four principles' which are intended to inform Ofgem's work⁷⁸. This does not encourage a belief that the department is yet completely persuaded of the benefits of full transparency in its relationship with Ofgem and to limiting its role to the (transparent) setting of the sort of strategic objectives which were meant to be the core reason for having the Statements.

10 Lessons for future political control of SOUs

Utilities have high political salience but politicians are not usually the best people to run utilities on a day-to-day basis. These two ideas underpinned the vision of Herbert Morrison for how nationalised industries should operate.

⁷⁶ Competition and Markets Authority (2016), 'Energy Market Investigation: Final Report', 24 June. <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

⁷⁷ Department of Business, Energy and Industrial Strategy (2019), 'The Government's Strategic Steer to the Competition and Markets Authority', July. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/818214/cma-strategic-steer.pdf

⁷⁸ Greg Clark (2018), 'After the trilemma - 4 principles for the power sector', speech given on 15 November. <https://www.gov.uk/government/speeches/after-the-trilemma-4-principles-for-the-power-sector>

- Politicians would have a role: they would appoint board members of the public corporations, including the Chairman; they would have the ability to approve or veto major expenditure programmes; and they could give formal (and, therefore, transparent) 'directions' on matters of public interest which could be questioned by, for example, MPs.
- But, in other respects, the boards of the public corporations - comprising competent and suitably public-spirited people - would have a great deal of autonomy, within a framework of very broadly drawn statutory obligations.

Put another way, politicians would be able to have an influence on strategy/policy issues but would stay out of operations. In practice, and as described above, this did not happen. In the words of Vickers and Yarrow, quoted at greater length in Section 4, "general guidance was rarely offered but specific interventions were common"⁷⁹.

The question, then, is whether the experience of the interaction between ministers and ('independent') regulators in the privatised era offers lessons for how political control of state-owned utilities could be exercised in the event of future renationalisations. Indeed, there are currently two examples of regulators being interposed between ministers and state-owned utilities: ORR in relation to Network Rail and the Water Industry Commission (WICS) for Scotland in relation to Scottish Water.

There is good evidence that, regardless of the ownership of the utilities in question, independent regulators can facilitate beneficial utility outcomes (including increased investment, lower prices for consumers). For example, Cambini and Rondi (2010)⁸⁰ and Abrardi, Cambini and Rondi (2018)⁸¹ have shown that, across the EU, the existence of independent regulatory agencies and the extent of their independence have had a positive impact on the level of investment by the regulated utilities, including state-owned utilities. Edwards and Waverman⁸² have shown that, although state ownership of incumbent telecoms operators tends to raise the interconnect rates (charged to other suppliers of telecoms services), the effect is mitigated by the independence of the regulator

What independence means, and what its purpose is, in this context is critical. It does not mean that politicians do not get involved in the activities of, and the desired outcomes from, utilities. As expressed by the OECD in a report on better regulation:

"Regulators are always subject to political pressure, because they make decisions about things that politicians care about. Political independence in the sense of such pressure being absent is an oxymoron. Independence, instead, should be seen as giving regulators the means to participate in the policy process to the extent this is needed for them to be able to function, recalling that the main functions are to bring more time-consistency into the decision-making process and containment of opportunistic behaviour."⁸³

⁷⁹ Vickers and Yarrow (1988), Op. cit., p. 128

⁸⁰ Cambini, C. and Rondi, L. (2010), 'Regulatory Independence, Investment and Political Interference: Evidence from EU', Journal of Regulatory Economics, August, 38(1): pp. 1 - 26

⁸¹ Abrardi, L., Cambini, C. and Rondi, L. (2018), 'The Impact of Regulation on Utilities' Investments: A Survey and New Evidence from the Energy Industry', De Economist, 166(1), pp. 41 - 62

⁸² Edwards, G. and Waverman, L. (2006), 'The Effects of Public Ownership and Regulatory Independence on Regulatory Outcomes', Journal of Regulatory Economics, January, 29(1), pp. 23 - 67

⁸³ OECD (2011), 'Better Economic Regulation: The Role of the Regulator', ITF Round Tables, No. 150, OECD Publishing. <http://dx.doi.org/10.1787/9789382103272-en>

The inevitability of politicians wanting to have influence over utilities was a starting assumption of both the two major official attempts to improve the interaction between ministers and utilities in the nationalised and privatised eras: the NEDO 1976 and the Department of Business, Innovation and Skills (BIS) 'Principles for Economic Regulation' in 2011. The relevant quotation from the NEDO report is in Section 5 above and the relevant quote in the BIS report is as follows.

"Setting the policy direction and making politically sensitive trade-offs between objectives is likely to require democratic legitimacy and accountability and is clearly the role of Government."⁸⁴

Both reports concluded that the key point was to have an independent agency between ministers and utilities. In the case of the NEDO, the recommendation was for Policy Councils and, in the case of BIS, it was all about how to reconcile 'independent' regulation with the need for politicians to be able to have their say (through, in particular, the role of Strategy and Policy Statements).

A key issue is whether there is a clear division of labour between the Minister and the regulator/other independent agency. Just as NEDO in 1976 bemoaned the lack of role clarity as between ministers and the boards of the public corporations, in the case of the privatised energy industry, there was a lack of clarity which underlay the conflicts between DECC and Ofgem, described in Section 8. This has been somewhat mitigated by a mixture of changes in Ofgem's statutory obligations and the Government taking more direct responsibility for contracting for low-carbon generation.

However, what the Ofgem example shows is that, if ministers are unwilling to accept the transparent institutionalisation of their involvement in utility outcomes, the value of having an independent intermediating organisation is weakened. It is, for example, noteworthy that BEIS has refused to accept the discipline of issuing a Strategy and Policy Statement to Ofgem. Beyond this, there are several reasons why nationalisation might make the suggested separation of roles even more difficult.

- One of the motives for nationalising a utility *may*, in effect, be to allow ministers to be able to get involved in the day-to-day decision making of utilities. It may, for example, be that ministers are either not that interested in efficiency per se or may believe that nationalisation will be enough to achieve this. If so, the experience with the nationalised industries from the 1940s onwards should serve as a warning.
- It is clear that, in the privatised period, the need to encourage private investment in the privatised utilities has exercised a degree of discipline on ministerial interventions in utility decision making. This is explicit in, for example, both in the BIS Principles for Economic Regulation and in DECC's rationale for Electricity Market Reform⁸⁵.

In short, on the one hand, the history of nationalised and privatised utilities in the UK suggests that, in order to reconcile political 'control' and utility efficiency, the following are desirable:

⁸⁴ Department for Business, Innovation and Skills (2011), Op. cit., p. 6

⁸⁵ For example, Department for Business, Innovation and Skills (2011), Op. cit., para. 5, talks of the role of 'appropriate' regulation as "a critical enabler of infrastructure investment". Similarly, DECC set out its Electricity Market Reform proposals as an essential enabler of the investment need in electricity generation and transmission to achieve its climate change and security of supply goals. See Department of Energy and Climate Change (2012), 'Electricity Market Reform: policy overview', November. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/65634/7090-electricity-market-reform-policy-overview-.pdf

- an independent agency between the relevant ministers and the relevant utilities;
- a transparent brief to the independent agency on how it should interpret its (inevitably high-level) statutory obligations;
- that brief to not change frequently (preferably, not more than one per Parliament) and to have as few objectives as possible (DEFRA's guidance to Ofwat does not score highly on this metric⁸⁶) and, if there are potential conflicts between some of those objectives, guidance on how trade-offs between different objectives should be made.

In addition, and although it is not the focus of this paper, some of the features of the various utility regulatory regimes, as they have evolved over the recent past, would look to be useful pointers for how regimes might operate in a renationalised world. These include:

- regular reviews by the intermediating agency of prices to be charged by a utility;
- the public availability of data (actually easier in relation to a SOU than in relation to privately owned companies) which facilitates the evaluation of both the financial and non-financial performance of the renationalised utilities by other stakeholders, as well as by the intermediating agency itself;
- a degree of contestability exerting pressure on those parts of the utility sector which are not competitive: both Ofgem and Ofwat, for example, have been keen to stimulate competition to provide major network enhancements, even if the completed assets are eventually owned by the incumbent utility.

On the other hand, either with private utilities or SOUs, sustained separation between the roles of ministers and that of intermediating agencies may prove too much to ask for. The recent record with the energy sector is not totally encouraging. Although institutional arrangements can encourage ministers to create a clear division of labour between themselves and independent agencies, they are not sufficient to do so if the minister in question is sufficiently motivated to blur the boundaries, not least because of the likely unpopularity of politically inspired decisions.

31 October 2019

⁸⁶ Department for Environment, Food & Rural Affairs (2017), 'The government's strategic priorities and objectives for Ofwat', September.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661803/sps-ofwat-2017.pdf